Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills: See Legislative History | Telephone: 845-5322 | Introduced Date: 2-24-2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Environmental Building Expenses Credit

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to an unspecified percentage of the cost of environmental building expenses paid or incurred to construct, repair, maintain, rehabilitate or improve a commercial or residential structure.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable and income years beginning on or after January 1, 2001.

LEGISLATIVE HISTORY

SB 2037 (2000) would allow a credit equal to 5% of the amount of environmental building costs (defined differently than this bill) expended on specified types of buildings.

SPECIFIC FINDINGS

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Generally, under **state and federal law** the cost of erecting a building or other structure or a major improvement or repair to an existing building is considered a capital expense. If the building or structure is used in a trade or business, the costs expended must be capitalized into the cost basis of the property and deducted against income through depreciation over the useful life of the building or structure. If the building is not used in a trade or business (a personal asset), costs expended must still be capitalized into the cost basis of the property. The cost basis of a personal asset is used to determine if a taxpayer has a taxable gain upon disposition of the personal property.

Under current **state and federal law,** a repair, renovation or improvement to a building that does not increase the value of the building or extend its useful life is considered a current period expense. If the building is used in a trade or business, the expense is deducted against income in the period the expense is paid or incurred. If the building is a personal asset, the costs expended are considered personal expenses of the taxpayer and are non-deductible and cannot be capitalized.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Alan Hunter for GHG	4/13/00
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This bill would allow a credit equal to an unspecified percentage of the cost of "environmental building expenses" paid or incurred to construct, repair, maintain, rehabilitate or improve a commercial or residential structure on or after January 1, 2001. "Environmental building expenses" are defined to mean a fixture, such as a device, material or mechanical component, certified by the California Environmental Protection Agency as being "environmentally sound" or certified by the California Energy Commission as being "energy efficient."

This bill defines "environmentally sound" as a fixture that has negative impacts on the environment that are scientifically demonstrable as less than any other product that is commonly used for the same purpose in a structure.

"Energy efficient" means a fixture that reduces the consumption of heat, process heat, space heating, water heating, steam, space cooling, refrigeration, mechanical energy or electricity.

Under the Revenue and Taxation Code, **this bill** would require the California Environmental Protection Agency and the California Energy Commission to complete the certification of fixtures by July 1, 2001, and annually update the list by each July 1 thereafter.

This bill would allow any unused credit in excess of the taxpayer's tax liability to be carried over to future years until exhausted.

Policy Considerations

While Section 1 of this bill expresses the Legislature's intent to provided and allocated tax credit, the credit provided by this bill would not be allocated by any state agency.

This bill would allow the credit for environmental building expenses for buildings located outside of California.

This bill would allow taxpayers in certain circumstances to claim multiple special tax credits for the same item of expense (e.g., Manufacturers' Investment, Enterprise Zone and Targeted Tax Area Credits.)

In the case of buildings being used in a trade or business, this bill would not require the basis of the building or the current expense to be reduced by the amount of the credit.

Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction or depreciation deduction. This new credit would provide a double benefit for these expense items. On the other hand, making an adjustment to reduce the basis or expense in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy. In the case of a one-time expense deduction, the reduction of that expense would not create an ongoing difference. However, if the expenditure must be capitalized, then an ongoing difference would be created.

This bill does not limit the annual aggregate credit amount that would be allowed to any one taxpayer.

This bill does not contain a sunset date. Credits are typically enacted for four to five years to allow the Legislature to examine the effectiveness of the new credit. Moreover, this bill provides an unlimited carryover of unused credit amounts. Recent credits have been enacted with a limited carryover since experience has shown that most credits are exhausted within eight years.

This bill does not require the environmental building expenses incurred by the taxpayer to be for new equipment and does not state a minimum amount of time the taxpayer must have the equipment placed in service to avoid recapture of the allowed credit. Without one of these requirements, more than one taxpayer could claim the credit on the same piece of equipment.

Implementation Considerations

This bill cannot be implemented without the percentage of the environment building expense paid or incurred that would qualify for the credit being specified.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The revenue estimate is unknown and cannot be determined until the percentage of environmental building expenses paid or occurred by the taxpayer is determined.

Based on actual departmental data regarding previous solar and energy credits, total environmental building expenses are projected to be on the order of $500 million annually.

BOARD POSITION

Pending.